Pension Funding Problems Grow

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WASHINGTON - Ray Brice, 62, of San Rafael, Calif., expected to cruise along after retiring as a United Airlines pilot two years ago with a $12,000-a-month pension. Not any more.

Last week's federal court ruling allowing United to terminate its drastically underfunded pension plan and pile $6.6 billion of liabilities onto a small federal agency, means his monthly check could be cut about 80%, to about $2,000.

Brice's situation is stark, but no longer unusual.

The United pension default - the largest in U.S. history - comes atop a string of bankruptcies and retirement plan meltdowns in the steel, retail and other industries in the past several years that have directly affected the retirement security of millions of Americans and prompted millions more to worry whether they're next.

The latest high-profile case illustrates what Bradley Belt, executive director of the federal Pension Benefit Guaranty Corp., which insures traditional pension plans, calls severe stress in the U.S. pension system. And it puts increased pressure on the White House and Congress to act before the situation becomes worse.

The PBGC, funded through corporate premiums, has moved from about a $10 billion surplus in the late 1990s to a $23 billion deficit in its single-employer insurance program. The agency had $39 billion in assets and $62 billion in long-term liabilities. At the same time, the PBGC estimates underfunding in the pension system has reached a record $450 billion, with auto, airline and retail industries at most risk.

"We have sufficient liquidity to pay benefits at the pace we're paying them now for several years, but we clearly do not have the ability over the long run to honor all the obligations we've taken on," Belt says.

The situation can be resolved three ways, he says: more money from corporate premiums; an eventual taxpayer bailout; or reduced pension benefits.

Beset by complex issues

Bankruptcies and underfunding aren't the only issues.

Companies are abandoning traditional defined-benefit plans - corporate-funded pensions that provide a set monthly payment on retirement - in favor of defined-contribution plans such as 401(k)s, in which employees make contributions, often with a company match. Half the pension plans in the country have been lost in the past decade, according to the American Benefits Council. About 41 million people are now covered by a traditional defined benefit, compared with 60 million in defined-contribution plans.

Many companies that still provide traditional pensions are freezing benefits and enrollment or shifting to so-called cash-balance plans and other hybrids that combine elements of traditional pensions and 401(k)s. Such plans now cover 25% of people in what are classified as traditional pensions. Even workers at healthy firms can suddenly see their pension plan altered in a corporate merger. And there is uncertainty about the security of cash-balance plans, due to court challenges.

The need to bolster pension funding is also one reason some companies have been slow to hire or expand capital spending.

Charles Warren, 63, of Surprise, Ariz., had his pension reduced by about $100 a month after the company he retired from, LaClede Steel, filed for bankruptcy. He retired in 2000 after working in materials management.

"It hurt," Warren says, "but I'm more concerned about what's going to happen now with the PBGC."

The White House and Congress hope to stabilize the pension system by passing legislation to tighten funding rules, increase premiums to the PBGC that are paid by firms that offer traditional pension plans, and make it harder for companies to make new promises to workers without funding them.

But there is concern from companies with healthy plans, who argue they should not have to pay to bail out irresponsible businesses. Airlines are lobbying for special treatment, arguing that the United decision has put them at a competitive disadvantage. Lawmakers worry that if they go too far, even fewer companies will offer pensions. And the issue could get tangled up with the debate about overhauling Social Security.

If Congress fails to find a solution, there is an increased chance other troubled firms will shed their plans as United did, and as a string of steel firms have already done. The PBGC has taken over 291 pension plans in the steel and metals industry since 1975, including a rash of closures in the past several years.

The PBGC estimates it faces about $96 billion in possible liabilities from firms with junk-bond credit ratings and a reasonable chance of pension plan termination. Among the biggest risks: about $40 billion in the manufacturing sector and $33 billion in airlines and other transportation companies, telecom and utilities.

"It definitely will affect everybody who has a defined-benefit plan. It won't just be limited to the auto industry," Rania Sedhom, a New York lawyer who specializes in employee benefits, says of the United decision. "Other industries are going to look to the airlines ... and say we need to do the same."

Anticipating such moves, Reps. George Miller, D-Calif., and Jan **Schakowsky**, D-Ill., Friday offered a bill to keep United and other companies from transferring liabilities to the PBGC for the next six months as Congress works on a solution.

No need for panic

While urging congressional action, and pointing to problems, Belt and other analysts say there is no cause for panic. Though pension plans at some large companies are seriously underfunded, several other businesses have bolstered their bottom lines.

Lehman Bros. in an April report said firms in nine out of 10 industry sectors on the Standard & Poor's 500 index improved their funding status last year, even while setting tighter standards. S&P companies are now about 11.2% underfunded, compared with 18.6% in 2002. If companies keep posting high profits and the stock market improves, the funding picture should keep getting better.

"You have this period right now when you haven't had great market performance ... and the result of that is there are a lot of underfunded pension plans," says Norman Stein, a professor at the University of Alabama School of Law, pointing out several years ago that pension plans were overfunded.

"I don't think you have to worry if you're in a healthy company that has an underfunded pension plan. Chances are pretty good that plan is going to be well-funded again," Stein said

But he adds that workers in companies with financial problems and underfunding have cause to worry.

How did we get here?

The rapid decline in pension funding is the result of a combination of the stock market swoon and historically low interest rates, which make long-term obligations appear larger. Stein says current problems are also influenced by globalization and government policies, such as airline deregulation, that changed the economic playing field for companies. Pension benefits that might have appeared affordable when first granted became onerous in different economic times.

Stein and some others say the PBGC numbers on underfunding might be overstated. But Belt says an improving economy won't fix problems in outdated laws.

"The current rules are demonstrably broken. If they worked, you wouldn't have a company being able to terminate its pension plan that is $10 billion underfunded; you wouldn't have participants losing $3 billion of benefits," Belt says of the United situation.

While the United decision has drawn attention to the issue, problems have been mounting for years. Bethlehem Steel in 2002 terminated a plan that was only 45% funded, for example, leaving the PBGC liable for about $3.7 billion in payments - and 95,000 workers and retirees.

A takeover by the PBGC, which doesn't insure 401(k) plans, means workers are guaranteed payments, but possibly not the full amount they had earned. For pension plans ending in 2005, the maximum PBGC payment is $45,613 annually, for workers retiring at age 65. (See story, below.)

Larry Arnold, 56, of Hamburg, N.Y., figures the PBGC's Bethlehem takeover cost him about $750 a month. Arnold had set up his retirement so he and wife Ann Marie, 54, would have all they needed to be comfortable - first with his steel company pension, then her pension from Verizon and finally, when he turned 60, a pension from his service in the Naval Reserve.

"We had this set up where the dominoes were going to fall," he says. "And they pull the first domino before I get a chance to use it, my full pension."

In the United case, pilots are in a difficult position because they are required by law to leave the cockpit by age 60. Yet, those who retire at that age can only get a maximum payout of $2,471 a month from the PBGC on pension plans it assumes this year, about two-thirds of what they would receive if they could work until 65.

"There's a lot of anger, dread, hopelessness," says Richard Bouska, 70, of Livermore, Calif., president of the Retired United Pilots Association, who retired from the airline 10 years ago. "We feel abused, betrayed, all those things."

Brice, the 62-year-old former United pilot, now finds he must return to work as a safety director for another airline. He has sold the twin-engine plane he always dreamed of owning, and his house is on the market.

"It just changed our lifestyle so dramatically. And you won't find two more bitter people," Brice says, of his wife and himself.

While lawmakers worry that companies will abandon pension plans if Congress comes down too hard, the White House argues that the current system is unsustainable. The White House proposal to shore up the system would increase the annual premium companies pay per participant to $30 from $19 and index it to wage growth. Congress in a budget bill, however, assumes a premium rise less than the White House wants.

The White House plan would also calculate pension liabilities on a different formula, let companies increase contributions in good financial times without as many tax penalties, and bar companies in financial difficulty or with underfunded plans from lump-sum pensions or new benefits. Firms at greater risk of default would face tighter rules.

Rep. John Boehner, R-Ohio, chair of the House Committee on Education and the Workforce, says he's optimistic.

"We haven't increased the premiums to the PBGC since 1991. It's clearly been a mistake," Boehner says. "The plan was to do this major pension overhaul this year, and I do think this United decision makes" that case more urgent.